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SUBJECT: CONOCPhillips SEEKS EXPLORATION BLOCK IN AZERBAIJAN

Classified By: Acting Deputy Chief of Mission Robert Garverick
Reasons 1.4 B and D

11. (C) SUMMARY: ConoCPhillips (CP) representatives visited Embassy Baku October 15 to discuss interest in renewing their energy exploration in Azerbaijan. CP left its two exploration fields in Azerbaijan about 4 years ago due to differences with SOCAR, the state oil company. It now believes the offshore Babek field is worth a second look, and is beginning to negotiate a possible exploration lease. In this regional trip, the CP executives will also visit Turkmenistan and Kazakhstan. CP underscored their interest in further exploration in Turkmenistan, and was keenly interested in USG views on further opening of Turkmen energy sector, and the state of Azerbaijani-Turkmen relations. Finally, with an eye to eventual transportation of Kashagan (Kazakhstan) Phase II oil, CP will pursue its top regional priority: ensuring their ability to bring Kashagan Phase II oil to the international market. They will continue to seek an ownership stake in the Kazakhstan Caspian Transportation System (KCTS). END SUMMARY.

CP Looks at Azerbaijan Again
Hopes Rest on the Babek Field

12. (C) Ryan Lance, Senior Vice President for Exploration and Production International (Houston-based); Don Walette, President, Russia and Caspian Region; and John Dabbar, Head of Oil and Gas Transportation, Russia and Caspian Region visited Charge D'Affairs Lu on October 14. ADCM Garverick and EnergyOff also participated. President Walette told us that CP had negotiated for access to two Azerbaijani blocks, Umid and Babek, about 3 to 4 years ago. The discussions broke down, largely due to "disagreements with their partners," that is, SOCAR. However, CP is now interested in taking another look at the Babek field. During their visit to Baku, they will meet with SOCAR President Rovnag Abdullayev, and Energy Minister Natiq Aliyev.

13. (C) No preliminary seismic data exists for the Babek field, but the CP team considers it "highly prospective." The Babek field is located in 500 meters of water, and is a deep reserve at about 6000 meters depth. The CP team considers the field to be technically challenging, hence SOCAR's need to bring in a IOC to assist with its development.

14. (SBU) Currently CP handles all of its major investment decisions for Russia and the Caspian region from Moscow. CP maintains contractors in Azerbaijan who conduct pipeline maintenance on the BTC pipeline, but the firm manages these operations from Moscow. If all goes well with the exploration lease negotiations, CP would hope to open a small

exploration and production office in Baku by mid-2010.

Kashagan: How to get the Oil Out to Market, and
Fighting for Ownership Stake in KCTS

15. (C) SVP Lance emphasized the CP's primary challenge in the region now is ensuring the evacuation of Kashagan Phase II oil. They indicated they are looking at various options, including evacuation by rail via Russia and Ukraine, or the expansion of the Atyrau facility. The team dismissed the prospects for shipping via the Caspian Pipeline Consortium, noting that Phase II oil would quickly swamp the CPC's capacity. They also described difficulties for third parties, like CP, to obtain access to CPC shipping capacity. In short, CP needs another evacuation route for Kashagan Phase II oil.

16. (C) If the Kashagan Phase II final investment decision proceeds apace, oil would come on-line by 2017-2018. Given that, the Kashagan consortium will likely have to make a decision by 2012 regarding whether to proceed with constructing a tanker system or a pipeline. However, President Wallethe stated that, in his opinion, neither the Kazak nor Azerbaijani government were willing to make a pipeline happen. The Embassy team noted that President Aliyev, to the contrary, had at times expressed interest in a sub-sea pipeline, but was left adrift given the Kazak government's apparent lack of commitment. The CP team told us that for a pipeline to move forward, the two governments would have to negotiate further intergovernmental agreements,

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and only then could consortium members seek possible OPIC support for political risk insurance.

17. (C) The CP team underscored their firm's interest in taking an ownership stake in the Kazakhstan Caspian Transportation System (KCTS), not merely shipping oil in a system owned by the Azerbaijani and Kazak national oil companies. The team was pleased to hear that DOE Deputy Secretary Poneman had only last week emphasized to SOCAR President Abdullayev the US companies interest in an equity stake. The CP team appeared to recognize they may face an uphill battle to obtain this, but nonetheless appeared somewhat optimistic. Beyond the obvious financial benefit, CP indicated that they would prefer to have an ownership stake in KCTS to ensure the tanker system is operated according to international standards. They acknowledged that shipping in a system operated solely by Kazakhstan and Azerbaijan could expose CP to a greater likelihood of environmental issues or an accident. Regardless of the outcome of the ownership debate, CP recognizes its interest in working to support the development of a the "software side," of KCTS, that is, the development of a professional merchant marine capability in the Caspian region.

Turkmenistan Interests

18. (C) On Turkmenistan, the CP team told us that they are now seeking offshore investment in Turkmenistan. In fact, they indicated, "we've been looking for 15 years," but the relationship had cooled under the former regime. Now, the Turkmen government has now re-invited CP to come back "to resume discussions." The team was eager for news of about the Azerbaijani-Turkmen relationship, and for USG views on possible further opening of the Turkmen energy sector. They indicated that in their experience, their relationship with Turkmenistan runs "hot and cold," often for reasons which were not clear.

Gas Interests: CP Lukewarm but Warming Up

¶9. (C) The CP team repeatedly mentioned that liquids were a far more favorable option for the firm than gas in this economic environment, but they are nonetheless studying their options for gas investment in the region. They indicated that gas was becoming a more interesting option for them, especially if there are associated liquids. They doubted that Nabucco would be a wise investment decision, at least in the near-term. On the proposed Italy Turkey Greece Interconnector (ITGI), CP noted that it has little presence in the Italian gas market, so the team offered no strong views.

Partnership with Lukoil;
"We're just Friends"

¶10. (C) The discussion then turned to prospects in Russia and CP's ties to Russia's Lukoil. Despite CP's ownership stake of 20% of Lukoil, the executives underscored that their "strategic alliance" with Lukoil did not extend even as far as the Russian border. Certainly beyond that, and each company is free to negotiate its own projects in the Caspian region. The team indicated that CP generally would be predisposed to work with Lukoil where their presence would be an asset, stating "sometimes it makes sense to team up." However, the team also recognized that Lukoil's presence could also be a liability in other locations in the Caspian region.

Yamal Peninsula

¶11. (C) On the question of the development of Russia's Yamal Peninsula, the team indicated that CP CEO Jim Mulva had indeed heeded Prime Minister Putin's late-hour summons to a recent meeting on development of the Yamal Peninsula. SVP Lance admitted that it is "hard to tell if Putin is serious" about Yamal's immediate development. CP has been informed that in Q1 2010, Russia will publish its plan for IOC partner selection and the Yamal participation model. The team seemed

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somewhat dubious about the immediate prospects for Yamal's development, as the field is technically difficult, and consequently will be very expensive to develop. SVP Lance stated that Yamal gas would likely require a substantial subsidy from the Russian government to develop at this time, as it is at the "tail end of the supply curve" in terms of cost. The team does not believe current world gas prices support Yamal's development on commercial terms now.

¶12. (C) Alternately, they indicated, Russia could continue to wait to develop the field. In the end, taking a 30 to 50 year perspective, the team emphasized CP's interest in Yamal. As a major IOC in competition on the world market, CP has no choice but to follow closely the development of Yamal Peninsula. SVP Lance stated that he thinks that PM Putin is "irritated by the limits of fixed lines (pipelines)," and so is now seriously looking initiating LNG projects from Yamal.

Comment

¶13. (C) It is far too early to gauge whether CP's current negotiations with SOCAR will come to fruit. Nonetheless, it is a positive indication of Azerbaijan's welcome to new foreign investment that that the firm felt welcome to return so soon after exiting.

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